

KALA EXPLORATION LTD.

APR 22 1986

NOTICE OF ANNUAL GENERAL MEETING  
May 6, 1986

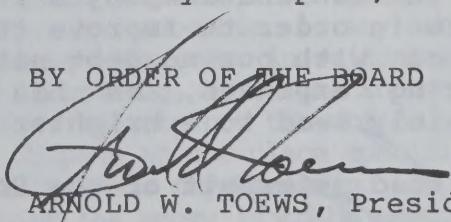
NOTICE IS HEREBY GIVEN that the Annual General Meeting of the Shareholders of Kala Exploration Ltd. (the "Corporation") will be held at the offices of the Corporation's solicitors, Howard, Mackie, 700, 801 Seventh Avenue S.W., Calgary, Alberta, on Tuesday, May 6, 1986 at 10:00 a.m. (Calgary time) for the following purposes, namely:

1. To receive the consolidated financial statements of the Corporation for the fiscal year ended October 31, 1985, together with the report of the Auditors thereon;
2. To elect Directors;
3. To appoint the Auditor of the Corporation;
4. To authorize the Directors to fix the remuneration of the Auditor of the Corporation; and
5. To transact such other business as may be properly brought before the meeting.

If you are unable to attend in person, kindly fill in, sign and return the enclosed instrument of proxy in the envelope provided for that purpose.

DATED at Calgary, Alberta the 11th day of April, 1986.

BY ORDER OF THE BOARD

  
ARNOLD W. TOEWS, President



**KALA EXPLORATION LTD.**

Suite 450, Northland Building  
910 - 7th Avenue S.W.  
CALGARY, Alberta  
T2P 3N8

PHONE: (403) 266-6939

April 11, 1986

**TO THE SHAREHOLDERS:**

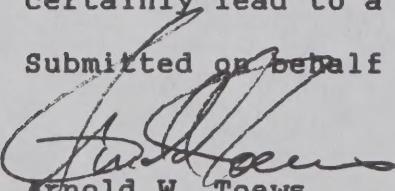
The past year has been a difficult one for Kala as is clearly reflected in our October 31, 1985 year end and January 31, 1986 first quarter financial statements. The main reasons for the difficult year were poor gas market conditions in the United States and excessive write-downs of our mining properties abandoned during the year.

Our overall revenue was down by 40% due primarily to the lack of gas sales from our Zaunbrecher #1 well in Louisiana, decreased oil revenue, and the loss in gas processing revenue from the compressor station which was sold during the year. In addition to lower revenue we also had to show a significant write-down on our mining property, leaving us in a net loss position of \$628,087 for the year.

On a more positive note, we have drilled two (2) successful wells in central Alberta during our first quarter of this year, one of which we have sold for a sizeable cash injection into our company subsequent to the January 31, 1986 financial statements. This will change our negative working capital position reported in the January 31, 1986 statement to a positive one in the following quarter. In addition to this we are attempting to have an additional well drilled on our Niton, Alberta property in order to be able to negotiate a gas contract for the area. At present we own a 54% interest in the area and have drilled one successful gas well testing 7.8 MMSCFD.

It is the company's intention to pursue ventures of this nature in order to improve the company's cash flow position. This coupled with our no debt situation and the continuing effort of reducing expenses, as has been the case this past year, will certainly lead to a brighter picture in the future.

Submitted on behalf of the Board,

  
Arnold W. Toews

KALA EXPLORATION LTD.

Annual General Meeting May 6, 1986

INFORMATION CIRCULAR

SOLICITATION OF PROXIES

THIS INFORMATION CIRCULAR IS FURNISHED IN CONNECTION WITH THE SOLICITATION OF PROXIES BY THE MANAGEMENT OF KALA EXPLORATION LTD. (the "Corporation") for use at the Annual General Meeting of the Shareholders of the Corporation to be held at Calgary, Alberta, on Tuesday, May 6, 1986 commencing at 10:00 a.m. (Calgary time) for the purposes set forth in the Notice of Annual General Meeting accompanying this Information Circular. Information contained herein is given as of April 1, 1986 except where otherwise indicated. The cost incurred in the preparation and mailing of both the proxies and this Information Circular will be borne by the Corporation.

APPOINTMENT AND REVOCATION OF PROXIES

Those shareholders desiring to be represented by proxy must deposit their forms of proxy at the office of National Trust Company, 150 Toronto Dominion Square, 320 8th Avenue S.W., Calgary, Alberta, T2P 3B2 at least twenty-four hours prior to the time of the meeting. A proxy must be executed by the shareholder or his attorney authorized in writing, or if the shareholder is a corporation, under its seal by an officer or attorney thereof duly authorized.

Each shareholder submitting a proxy has the right to appoint a person or corporation to represent him or it at the meeting other than the person designated in the form of proxy furnished by the Corporation. The shareholder may exercise this right by striking out the names of the person so designated and inserting the name of the desired representative in the blank space provided, or by completing another proper form of proxy and in either case depositing the proxy with National Trust Company at the place and within the time specified above for deposit of proxies.

An instrument of proxy may be revoked by the person giving it at any time prior to the exercise thereof. If a person who has given a proxy attends personally at the meeting at which such proxy is to be voted, such person may revoke the proxy and vote in person. In addition to revocation in any other manner permitted by law, a proxy may be revoked by instrument in writing executed by the shareholder or his attorney authorized in writing, or if the shareholder is a corporation, under its seal or by an officer or attorney thereof duly authorized, and deposited with National Trust Company at the place specified above at any time up to and including the last business day preceding the day of the meeting, or any adjournment thereof, at which the proxy is to be used, or with the Chairman of such meeting on the day of the meeting, or adjournment thereof, and upon either of such deposits the proxy is revoked.

#### EXERCISE OF DISCRETION BY PROXY

The shares represented by the proxy enclosed with this circular will be voted as specified by the shareholder, but if no specification is made they will be voted in favour of the resolutions described herein. If any amendments and/or variations to the resolutions are proposed at the meeting or any adjournment thereof, or if any other matters properly come before the meeting or any adjournment thereof, the proxy confers upon the shareholder's nominee discretionary ability to vote on such amendments and or variations or such other matter as according to the best judgment of the person voting the proxy at the meeting. At the date of this circular the management of the Corporation knows of no such amendments and/or variations or other matters to come before the meeting other than the resolutions described herein.

#### VOTING SECURITIES AND PRINCIPAL HOLDERS OF VOTING SECURITIES

As at April 1, 1986, the Corporation had outstanding 4,994,446 Class A common voting shares without nominal or par value (the "Common Shares"). Each Common Share confers upon the owner thereof the right to one vote.

Langard Stables Ltd., a corporation controlled by Albert J. Langard, owns beneficially 1,481,481 Common Shares representing 29.6% of the total Common Shares outstanding.

In accordance with section 128(3) of the Business Corporations Act (Alberta), the record date for the determination of shareholders entitled to receive notice of the annual general meeting is the close of business on April 11, 1986. Every shareholder of the Corporation on the date of the Annual General Meeting will be entitled to attend and vote therein either in person or by proxy. The transfer books of the Corporation will not be closed.

#### CONSOLIDATED FINANCIAL STATEMENTS

Pursuant to the Business Corporations Act (Alberta), the consolidated financial statements of the Corporation for the fiscal year ended October 31, 1985, together with the report of the Auditors thereon, will be presented to shareholders at the annual general meeting.

#### ELECTION OF DIRECTORS

At the Annual General Meeting, it is proposed that three directors be elected until the next Annual General Meeting or until the successors are elected or appointed. Each of the Nominees listed in the following table has served as a Director of the Corporation or its predecessors since the year he first became a director. Each Nominee is presently a member of the audit committee of the Corporation.

Name	Year first became director	Office or Position and Principal Occupation	Number of Common Shares Beneficially Owned directly or indirectly
Arnold W. Toews	1980	President and Director; President of Perfex Consulting Ltd.	143,378
Albert J. Langard	1981	Director; President of Langard Stables Ltd.	1,481,481
John B. Thorpe	1980	Vice President and Director; Chartered Accountant and President of John B. Thorpe Enterprises Ltd.	Nil

#### **REMUNERATION OF DIRECTORS AND OFFICERS**

No remuneration is paid to directors and officers of the Corporation. Management of the Corporation is provided through a management contract. (See "Management Contract")

#### **APPOINTMENT OF AUDITOR**

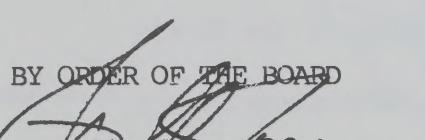
It is proposed to nominate Diamond Lalji Professional Corporation as the Auditor of the Corporation to hold office until the next Annual General Meeting. Collins Barrow have been the Auditors of the Corporation in previous years.

#### **MANAGEMENT CONTRACT**

Perfex Consulting Ltd., of which Arnold W. Toews, Calgary, Alberta is the sole principal, has agreed to provide management services to the Corporation for a fee of \$6,000 per month. Arnold W. Toews is responsible for performing the management functions. Pursuant to this contract, Mr. Toews has received \$72,000 for the period November 1, 1984 to October 31, 1985.

DATED April 11, 1986

BY ORDER OF THE BOARD

  
ARNOLD W. TOEWS, President

**KALA EXPLORATION LTD.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**OCTOBER 31, 1985**

# COLLINS BARROW

CHARTERED ACCOUNTANTS

VANCOUVER CALGARY EDMONTON WINNIPEG  
SUDBURY TORONTO OTTAWA MONTREAL  
QUEBEC CITY HALIFAX MONCTON  
AND OTHER CITIES IN CANADA

REPRESENTATIVES IN PRINCIPAL  
AREAS OF THE WORLD

TELEPHONE (403) 298-1500

800 GULF CANADA SQUARE  
401-9TH AVENUE S.W.

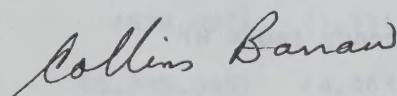
CALGARY, CANADA T2P 3C5

## AUDITORS' REPORT

To the Shareholders  
Kala Exploration Ltd.

We have examined the consolidated balance sheet of Kala Exploration Ltd. as at October 31, 1985 and the consolidated statements of loss and deficit and cash flow for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at October 31, 1985 and the results of its operations and cash flow for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.



CHARTERED ACCOUNTANTS

Calgary, Alberta  
January 29, 1986

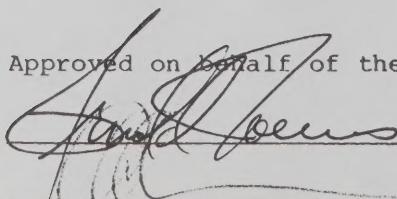
## KALA EXPLORATION LTD.

## CONSOLIDATED BALANCE SHEET

OCTOBER 31, 1985

	<u>ASSETS</u>	<u>1985</u>	<u>1984</u>
Current assets			
Cash	\$ 6,986	\$ 9,246	
Accounts receivable	<u>64,237</u>	<u>679,642</u>	
	<u>71,223</u>	<u>688,888</u>	
Investment in shares	<u>-</u>	<u>22,000</u>	
Property and equipment (note 2)	<u>3,641,545</u>	<u>3,794,028</u>	
	<u>\$ 3,712,768</u>	<u>\$ 4,504,916</u>	
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities	\$ 42,513	\$ 160,254	
Advances from an affiliated company (note 3)	<u>12,000</u>	<u>-</u>	
	<u>54,513</u>	<u>160,254</u>	
Advances from affiliated companies (note 4)	<u>41,650</u>	<u>99,970</u>	
SHAREHOLDERS' EQUITY			
Share capital (note 5)	10,039,737	10,039,737	
Deficit	<u>(6,423,132)</u>	<u>(5,795,045)</u>	
	<u>3,616,605</u>	<u>4,244,692</u>	
Contingency (note 8)	<u>\$ 3,712,768</u>	<u>\$ 4,504,916</u>	

Approved on behalf of the Board,

 , Director

, Director

## KALA EXPLORATION LTD.

## CONSOLIDATED STATEMENT OF LOSS AND DEFICIT

YEAR ENDED OCTOBER 31, 1985

	<u>1985</u>	<u>1984</u>
<b>Revenue</b>		
Oil and gas sales, net of royalties	\$ 185,080	\$ 301,315
Gas processing	20,045	56,041
Alberta Royalty Tax Credit	18,421	31,947
Interest and other	<u>7,964</u>	<u>916</u>
	<u>231,510</u>	<u>390,219</u>
<b>Expenses</b>		
Production	60,848	127,285
Gas processing	15,312	19,348
General and administrative	79,612	108,336
Write-down of petroleum and natural gas leases and rights to net realizable value	-	870,000
Write-down of mining properties abandoned during the year	542,962	450,000
Depletion and depreciation	<u>71,500</u>	<u>97,150</u>
	<u>770,234</u>	<u>1,672,119</u>
Loss before the following	(538,724)	(1,281,900)
Loss on disposal of compressor station	(67,363)	-
Earnings (loss) before extraordinary item	(606,087)	(1,281,900)
<b>Extraordinary item</b>		
Write-down of investment in shares to net realizable value	<u>22,000</u>	<u>50,000</u>
Net loss	(628,087)	(1,331,900)
Deficit, beginning of year	(5,795,045)	(4,463,145)
Deficit, end of year	<u><u><u><u><u>(6,423,132)</u></u></u></u></u>	<u><u><u><u><u>(5,795,045)</u></u></u></u></u>
Loss per share (note 9)		

KALA EXPLORATION LTD.

CONSOLIDATED STATEMENT OF CASH FLOW

YEAR ENDED OCTOBER 31, 1985

	<u>1985</u>	<u>1984</u>
<b>Operating activities</b>		
Oil and gas receipts, net of royalties	\$ 235,109	\$ 269,233
Gas processing receipts	20,045	56,041
Alberta Royalty Tax Credit receipts	57,646	5,325
Interest and other receipts	7,964	916
Operating payments	<u>(176,592)</u>	<u>(202,430)</u>
	<u>144,172</u>	<u>129,085</u>
<b>Financing activities</b>		
Advances from affiliated companies	14,964	4,319
Advances from (to) an affiliated company	<u>(14,404)</u>	<u>15,000</u>
Proceeds from issuance of share capital	-	1,169,787
Cost of share issuance payments	<u>(33,935)</u>	<u>(4,278)</u>
	<u>(33,375)</u>	<u>1,184,828</u>
<b>Investing activities</b>		
Petroleum incentive payment receipts	508,543	108,493
Proceeds on sale of compressor station	40,000	-
Payment of refundable deposit	<u>(1,000)</u>	<u>-</u>
Repayments from (advances to) a joint venture participant	<u>(7,873)</u>	<u>45,861</u>
Acquisition of property and equipment	<u>(652,727)</u>	<u>(1,697,562)</u>
	<u>(113,057)</u>	<u>(1,543,208)</u>
<b>Cash outflow</b>	<u>(2,260)</u>	<u>(229,295)</u>
<b>Cash, beginning of year</b>	<u>9,246</u>	<u>238,541</u>
<b>Cash, end of year</b>	<u>\$ 6,986</u>	<u>\$ 9,246</u>

KALA EXPLORATION LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

OCTOBER 31, 1985

1. Significant accounting policies

a) Principles of consolidation

The consolidated financial statements include the accounts of the company and its wholly-owned subsidiary companies: Golex Resources Inc. and 293901 Alberta Inc.

b) Exploration and development costs

The company follows the full cost method of accounting whereby all costs related to the exploration for and the development of oil and gas reserves are initially capitalized. Costs capitalized include land acquisition costs, geological and geophysical expenditures, rentals on undeveloped properties, costs of drilling productive and non-productive wells, together with overhead directly related to exploration and development activities. Proceeds on disposal of properties are ordinarily deducted from costs without recognition of profit or loss, unless the disposal significantly alters the relationship between capitalized costs and proven reserves, in which case a gain or loss on disposal would be recorded.

Exploration and development costs are allocated to one cost centre, namely North America (Canada and the United States).

Costs capitalized in the cost centre are depleted using the composite unit-of-production method which is based on estimated proven oil and gas reserves as determined by independent consulting engineers.

The company employs a ceiling test annually whereby capital costs would be written off should they exceed the present value of future net revenues from estimated production of proven reserves, together with undeveloped land at the lower of cost and net realizable value.

c) Joint venture accounting

Substantially all of the exploration and production activities of the company are conducted jointly with others and, accordingly, these consolidated financial statements reflect only the company's proportionate interest in such activities.

KALA EXPLORATION LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

OCTOBER 31, 1985

**1. Significant accounting policies (cont'd)**

**d) Translation of foreign currencies**

The accounts of its foreign subsidiary have been translated to Canadian dollars on the following basis: Monetary assets and liabilities at the rate of exchange in effect at the year-end; non-monetary assets and liabilities at the rate of exchange in effect at the date of settlement. Revenue and expense items are translated using average rates of exchange prevailing throughout the year except for depletion and depreciation, which are translated at the same rates as used for the related assets. Realized exchange gains or losses are credited or charged to earnings.

**e) Depreciation**

- i) Production equipment is depreciated using the composite unit-of-production method.
- ii) Other equipment is depreciated using the declining balance method at 20% per annum.

**f) Loss per share**

Basic loss per share is based on the weighted average number of common shares outstanding during the year.

**2. Property and equipment**

Property and equipment is comprised of the following:

	<u>1985</u>		<u>1984</u>
	<u>Cost</u>	<u>Accumulated Depletion &amp; Depreciation</u>	<u>Net</u>
<b>Petroleum and natural gas leases and rights including exploration and development costs</b>			
thereon	\$ 3,659,583	\$ 243,780	\$ 3,415,803
Production equipment	236,202	29,270	206,932
Compressor station	-	-	117,763
Mining properties	-	-	542,510
Other	32,202	13,392	18,810
	<u>\$ 3,927,987</u>	<u>\$ 286,442</u>	<u>\$ 3,641,545</u>
	<u>=====</u>	<u>=====</u>	<u>=====</u>
			\$ 3,794,028

KALA EXPLORATION LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

OCTOBER 31, 1985

3. Advances from an affiliated company

	<u>1985</u>	<u>1984</u>
Advances from an affiliated company, whose major shareholder is President of Kala, bear interest at 12.25% per annum and is repayable on or before January 1, 1986	\$ 12,000	\$ -

4. Advances from affiliated companies

	<u>1985</u>	<u>1984</u>
Advances from companies who were affiliated during the year through common management and through common shareholdings by a major shareholder and director of the company, are non-interest bearing and without stated terms of repayment	\$ 41,650	\$ 99,970

5. Share capital

i) Authorized

Unlimited preferred shares  
Unlimited Class A common voting shares  
Unlimited Class B common voting shares  
Unlimited Class C common non-voting shares

ii) Issued

	<u>Stated Value</u>	<u>Net of</u>	<u>Issuance Costs</u>
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	<u>1985</u>	<u>1984</u>
4,994,446 Class A shares	\$ 10,039,737	\$ 10,039,737

KALA EXPLORATION LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

OCTOBER 31, 1985

5. Share capital (cont'd)

Included in the total of 4,994,446 shares are 244,544 shares of the amalgamated company which are being held by the transfer agent to be exchanged for shares of the predecessor companies when they are tendered. Unexchanged shares of the predecessor companies result from a share for share exchange and subsequent amalgamation of the companies involved during the year ended October 31, 1982.

As at October 31, 1985, 268,729 Class A common shares were reserved under stock option agreements granted to officers, directors and employees of the Company. These options are exercisable at a price of \$0.25 per share and expire on April 7, 1987.

6. Segmented information

The company's exploration, development and production activities are conducted primarily in the resource industry and can be geographically segmented as follows:

	<u>Canada</u>	<u>United States</u>	<u>Total</u>
1985			
Revenue	\$ 203,793	\$ 19,753	\$ 223,546
Operating profit	129,509	17,877	147,386
Interest and other			(7,964)
General and administrative			79,612
Write-down of mining properties			
abandoned during the year			542,962
Depletion and depreciation			71,500
Loss on disposal of compressor station			67,363
Write-down of investment in			
shares to net realizable value			22,000
Net loss			\$ 628,087
Property and equipment	\$ 2,665,697	\$ 975,848	\$ 3,641,545
Other	68,843	2,380	71,223
Total identifiable assets	\$ 2,734,540	\$ 978,228	\$ 3,712,768

KALA EXPLORATION LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

OCTOBER 31, 1985

6. Segmented information (cont'd)

	<u>Canada</u>	<u>United States</u>	<u>Total</u>
<u>1984</u>			
Revenue	\$ 299,057	\$ 90,246	\$ 389,303
Operating profit	\$ 159,261	\$ 83,409	<u>242,670</u>
Interest and other			(916)
General and administrative			108,336
Write-down of petroleum and natural gas leases and rights to net realizable value			870,000
Write-down of mining properties abandoned during the year			450,000
Depletion and depreciation			97,150
Write-down of investment in shares to net realizable value			<u>50,000</u>
			<u>1,574,570</u>
Net loss			<u><u>\$(1,331,900)</u></u>
Property and equipment	\$ 2,809,742	\$ 984,286	\$ 3,794,028
Other	<u>660,479</u>	<u>50,409</u>	<u>710,888</u>
Total identifiable assets	<u><u>\$ 3,470,221</u></u>	<u><u>\$ 1,034,695</u></u>	<u><u>\$ 4,504,916</u></u>

7. Remuneration of directors and officers

The total remuneration paid to directors and officers of the company for the year ended October 31, 1985 amounted to \$77,000 (1984 - \$78,389).

8. Contingency and related party transaction

During the year, the Company purchased certain oil and gas properties for \$400,000 from a corporation related through common shareholding by a major shareholder and director of the company.

KALA EXPLORATION LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

OCTOBER 31, 1985

8. Contingency and related party transaction (cont'd)

The properties were purchased prior to the other corporation becoming bankrupt. At year end, the trustee of the bankrupt corporation has taken no action regarding the legitimacy of this transaction. The outcome of any legal action is undeterminable at this time and will be treated as a prior period adjustment on resolution of the contingency.

9. Loss per share

	<u>1985</u>	<u>1984</u>
Before extraordinary item	\$ (0.121)	\$ (0.287)
Extraordinary item	(0.004)	(0.011)
Net loss	\$ (0.125)	\$ (0.298)

10. Subsequent event

Subsequent to year end, a significant reduction in the world price of oil occurred. Due to the present uncertainty regarding this event, an estimate of the financial effect to the financial statements of the Company cannot be made.

11. Comparative figures

Certain comparative figures have been reclassified to conform with current year presentation.

2000, REVENUE ACCOUNT

GENERAL INFORMATION, DEPARTMENT OF EXPLORATION

For the year ended January 31, 1986

(Dollars)

	THOUSANDS	THOUSANDS	THOUSANDS
REVENUE	1,000	1,000	1,000
Less: and other, net of royalties	100	100	100
Less: production taxes	100	100	100
Less: and other	100	100	100
NET REVENUE	500	500	500

**KALA EXPLORATION LTD.**

**CONSOLIDATED FINANCIAL STATEMENTS**

January 31, 1986

	THOUSANDS
Net revenue	500
Royalty, exploration costs	100
NET REVENUE	400

	THOUSANDS
NET REVENUE	400
GENERAL EXPENSES	100
NET REVENUE	300

NOTES AND DISCLOSURES

REVENUE

GENERAL INFORMATION

DEPARTMENT OF EXPLORATION

GENERAL INFORMATION

**KALA EXPLORATION LTD.**

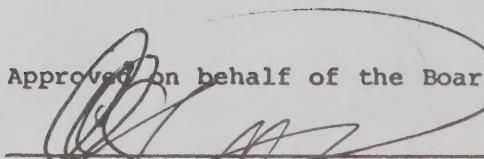
**CONSOLIDATED BALANCE SHEET**

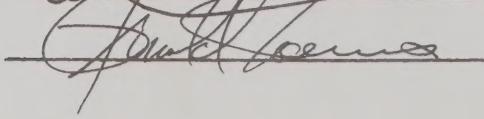
**JANUARY 31, 1986**

**(unaudited)**

	<b>ASSETS</b>	<b>1986</b>	<b>1985</b>
<b>Current assets</b>			
Cash	\$ 1,246	\$ 2,818	
Accounts receivable	<u>169,886</u>	<u>310,254</u>	
	<u>171,132</u>	<u>313,072</u>	
<b>Due from related companies</b>	<u>0</u>	<u>285,934</u>	
<b>Investment in shares</b>	<u>0</u>	<u>22,000</u>	
<b>Property and equipment</b>	<u>3,663,908</u>	<u>3,801,775</u>	
	<u>\$ 3,835,040</u>	<u>\$ 4,422,781</u>	
	=====	=====	
	<b>LIABILITIES</b>		
<b>Current liabilities</b>			
Accounts payable and accrued liabilities	\$ 185,002	\$ 170,674	
Advances from affiliated companies	<u>33,307</u>	<u>0</u>	
	<u>218,309</u>	<u>170,674</u>	
	<b>SHAREHOLDERS' EQUITY</b>		
<b>Share capital</b>	<b>10,039,737</b>	<b>10,039,737</b>	
<b>Deficit</b>	<u>(6,423,006)</u>	<u>(5,787,630)</u>	
	<u>3,616,731</u>	<u>4,252,107</u>	
	<u>\$ 3,835,040</u>	<u>\$ 4,422,781</u>	
	=====	=====	

Approved on behalf of the Board,

, Director

, Director

**KALA EXPLORATION LTD.**

**CONSOLIDATED STATEMENT OF EARNINGS AND DEFICIT**

**FOR THE THREE MONTHS ENDED JANUARY 31, 1986**

**(unaudited)**

	<b><u>1986</u></b>	<b><u>1985</u></b>
<b>Revenue</b>		
Oil and gas sales, net of royalties	\$ 60,923	\$ 60,298
Gas processing	60	12,836
Alberta Royalty Tax Credit	3,653	5,612
Interest and other	<u>842</u>	<u>337</u>
	<u><b>65,478</b></u>	<u><b>79,083</b></u>
 <b>Expenses</b>		
Production	37,731	24,136
Gas processing	2,079	4,958
General and administrative	10,492	19,274
Depletion and depreciation	<u>15,050</u>	<u>23,300</u>
	<u><b>65,352</b></u>	<u><b>71,668</b></u>
 <b>Net earnings</b>	<b>126</b>	<b>7,415</b>
 <b>Deficit, beginning of period</b>	<b>(6,423,132)</b>	<b>(5,795,045)</b>
 <b>Deficit, end of period</b>	<b><u>\$ (6,423,006)</u></b>	<b><u>\$ (5,787,630)</u></b>
	<u>=====</u>	<u>=====</u>

**KALA EXPLORATION LTD.**

**CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION**

**FOR THE THREE MONTHS ENDED JANUARY 31, 1986**

**(unaudited)**

	<b>1986</b>	<b>1985</b>
<b>Working capital was provided by</b>		
<b>Current operations</b>	<b>\$ 15,176</b>	<b>\$ 30,715</b>
<b>Working capital was used by</b>		
<b>Acquisition of property and equipment</b>	<b>37,413</b>	<b>127,799</b>
<b>Repayment of advances from affiliated companies</b>	<b>41,650</b>	<b>385,904</b>
	<b>79,063</b>	<b>513,703</b>
<b>Increase (decrease) in working capital</b>	<b>(63,887)</b>	<b>(482,988)</b>
<b>Working capital, beginning of period</b>	<b>16,710</b>	<b>625,386</b>
<b>Working capital, end of period</b>	<b>\$ (47,177)</b>	<b>\$ 142,398</b>
	<b>=====</b>	<b>=====</b>